MORNING BRIEFING
September 30, 2021

September, Energy, & Crypto

Check out the accompanying chart collection.

(1) Glad September is almost over. (2) Higher rates help S&P 500 Financials, and higher oil boosts S&P 500 Energy. (3) Higher commodity and transport prices hit earnings. (4) Vietnam's factory closures hurting US retailers. (5) Rising energy prices around the world raise questions about green energy. (6) The price of Europe's carbon credits doubles this year. (7) China's factories facing blackouts. (8) Everyone wants LNG, and the US is selling it. (9) Cryptocurrencies face criticism from Dimon and Gensler. (10) China ends debate and bans cryptocurrency transactions and mining. (11) Meet Mr. Goxx, a crypto-investing hamster.

Strategy: October Is Coming. September lived up to its reputation and dented stock portfolio returns, but not too badly. The S&P 500 fell 3.8% mtd through Tuesday's close, but the index remains solidly in positive territory, up 15.9% ytd through Tuesday's close. Surging interest rates and higher oil and gas prices in September helped insulate the Energy and Financial sectors while hurting the Real Estate and Utilities sectors.

Here's the performance derby for the S&P 500 and its sectors for the month of September through Tuesday's close: Energy (10.9%), Financials (-0.4), Consumer Discretionary (-1.2), Consumer Staples (-3.5), S&P 500 (-3.8), Industrials (-4.3), Information Technology (-5.1), Health Care (-5.2), and Materials (-5.6), Real Estate (-5.8), Communication Services (-6.0), and Utilities (-6.9) (*Fig. 1*).

The ytd performance derby for the S&P 500 and its sectors is a much happier picture: Energy (40.4%), Financials (29.4), Real Estate (23.2), Communication Services (21.6), S&P 500 (15.9), Information Technology (15.4), Health Care (12.7), Industrials (12.6), Consumer Discretionary (11.3), Materials (11.2), Consumer Staples (3.7), and Utilities (1.3) (*Fig. 2*).

There has been a lot of concern that higher wages, higher energy prices, and higher transportation costs will weigh on earnings for the remainder of this year and into 2022. It's certainly something we'll be tracking. But so far, analysts remain relatively sanguine, forecasting that S&P 500 earnings will rise 9.2% next year on top of a 46.3% expected jump in earnings growth this year (*Table 1*). Here's a quick look at what some companies have been saying about the price pressures they're facing:

(1) *Raw materials prices and supplies color Sherwin Williams earnings.* The lack of availability and rising prices of raw materials prompted Sherwin Williams to lower its Q3 and 2021 forecasts. The change was blamed on Hurricane Ida, which hit Gulf Coast suppliers harder than expected. To diversify its supply chain, Sherwin Williams announced that it purchased a resin manufacturer with locations in Oregon and South Carolina.

Paint company executives on a *conference call* emphasized that demand was not the problem and should remain strong well into 2022. However, tight supplies are expected to dent Q3 sales, which are now forecast to be flat or down slightly instead of the company's September 8 expectation of up or down slightly. Raw materials costs are expected to rise by a percentage in the high teens for the full-year 2021 versus the previously expected mid-teens. And adjusted diluted net income is forecast to be \$8.35-\$8.55 per share this year, down from the September 8 forecast of \$9.15-\$9.45, a September 28 company *press release* stated.

(2) *Food prices on the rise.* US food companies—including Campbell Soup, Conagra Brands, General Mills, and J.M. Smucker—are also facing higher costs and passing some of that cost on to consumers, a September 22 *WSJ* *article* reported. Companies noted that they're paying higher prices on everything from raw ingredients, cooking oil, steel, fuel, and shipping while also juggling labor shortages and wage increases. Smucker reported that the frost in Brazil and heatwave in the US Pacific Northwest hurt harvests of coffee and fruit, while the February frost in Texas that closed chemical plants kept packaging prices high.

Higher food prices and labor shortages are also pressuring restaurants. Darden Restaurants—which owns Olive Garden and LongHorn Steakhouse, among other chains—sees inflation of about 4% during fiscal 2022 (ending May) as commodity and labor costs rise, a September 23 *WSJ* *article* reported. The company said it has one or two sections with six to eight tables "closed at most restaurants on most nights due to staffing limits." And it can't pass all of its cost increases on to customers for fear of pricing the average customer out of the casual dining experience.

(3) *Higher clothing prices coming?* Last week, Nike cut its sales forecast due to disruptions in transportation and the closure of factories in Vietnam due to Covid-19. More than half of Nike's footwear is produced in Vietnam, where nearly all factories are closed. As a result, the company warned that its fiscal Q2 (ended August) sales would be flat to down and that fiscal 2022 sales (ending May) would grow by a mid-single-digit percentage, down from previous expectations for low-teens growth.

Nike isn't alone. Vietnam is the second largest supplier of apparel and footwear to the US after China, a September 29 *NYT* *article* reports. So retailers in developed countries have vaccinated customers looking to shop, but their inventories are thin because their suppliers' factories are in sparsely vaccinated, Covid-ravaged places like Vietnam, where only 15.4% of the population had received one vaccination as of the beginning of September.

This could mean retailers will have less inventory during the holiday season, giving them the ability to raise prices and to avoid the holiday sales usually used to clear out remaining year-end inventory.

Energy: Costly Transition. For various reasons, the price of energy—electricity, natural gas, oil, and coal—is going through the roof around the world. Renewable energy advocates are about to find out how much the world is willing to pay to wean itself off fossil fuels.

True believers may view today's high energy prices as the latest signal that we should double down on producing renewable energy so that we're not dependent on natural gas or coal in the future. But we have a feeling that politicians may not be that resolute. High electricity prices and blackouts have a way of sharpening politicians' focus on securing reasonably priced energy for their constituents to avoid being shown the door on election day. Here's a quick look at the intertwined fates of the energy and carbon markets:

(1) *All prices heading up.* Break out your sweaters: It may be very expensive to heat our homes this winter. The Brent crude oil futures price has risen to $79.09 per barrel as of Tuesday's close, up from $51.09 at the start of 2021 and $19.33 at its pandemic low in 2020 (*Fig. 3*). The prices of gasoline and heating oil futures price have also surged, by 56% and 54% ytd (*Fig. 4*). Following the same trajectory, the price of natural gas futures hit a recent high of $5.84, up from $2.54 at the start of this year and the highest level since February 21, 2014 (*Fig. 5*). Even the dreaded coal is undergoing a revival of sorts as coal-fired electric plants, the dirty villains of the energy industry, are being switched on to meet electricity demand.

As we mentioned in last Thursday's *Morning Briefing*, capital expenditures for upstream oil and gas projects worldwide fell more than 25% in 2020 to about $305 billion, down from $420 billion a year earlier, according to data from Statista. This year, capex is expected to increase by only 2% to $310 billion, which won't likely keep pace with increasing demand.

And just as energy prices have climbed, so too has the price for carbon credits in Europe's

Emission Trading System—almost doubling to roughly €65 from €35 at the start of this year. As utilities have upped their power generation, they've needed to buy carbon credits to offset the amount of carbon dioxide they're producing. Also boosting the price: Investors have reportedly jumped into the market. The higher price of carbon credits is increasing the costs for utilities in Europe, a cost likely to be passed down to consumers and industrial customers.

One might think the rising prices of energy and carbon credits in Europe would push production offshore to cheaper pastures. However, the EU plans to pass a carbon tax on imports of items like steel to level the playing field for its domestic producers.

(2) *China facing blackouts too.* China's energy shortages may have different roots, but they are painful to individuals and businesses. In attempts to reduce energy consumption and carbon emissions, "local officials have forced factories in China's Guangdong and Jiangsu provinces to curtail operation hours or shut down temporarily," a September 27 *WSJ* *article* reports. A Guangzhou handbag accessories factory was ordered by the local government to cut production and operate only two days a week, according to the WSJ article.

Officials may be trying especially hard to reduce emissions in the weeks prior to a UN environmental conference on October 12-13 hosted by China's southwestern city of Kunming. That's followed by the 2022 Winter Olympics opening on February 4 in Beijing. The government has said it will cut energy intensity per unit of GDP by about 3% from last year in an effort to reach peak carbon emissions before 2030. The country also has promised to end funding for coal electric plants overseas.

Surging coal prices are forcing factories to cut production. Coal supply was hurt when China banned the import of coal from Australia after the Aussies angered the Chinese by calling for an independent global inquiry into the origins of Covid-19. In addition, some of China's highest-quality, easiest-to-mine coal mines have been depleted. A September 29 *South China Morning Post* *article* reported that China's six major power generation groups have stockpiles to meet demand for only 15 days, a near record low; in theory, inventory should equal no less than 20 days' worth of consumption.

The combination of government dictates to reduce energy consumption and the shortage of coal have affected electricity availability. A September 28 Bloomberg *article* estimates that "at least 20 Chinese provinces and regions, making up more than 66% of the country's gross domestic product, have announced some form of power cuts, mostly targeted at heavy industrial users." There are also reports of blackouts in some areas.

The more that Chinese factories shut down, the more likely the US will feel the impact. A Toyota spokesperson said its operations were being affected, as were areas of China that produce steel, nickel, and materials used in semiconductors. Ten Taiwanese semiconductor-related companies temporarily closed facilities in Kushan (near Shanghai), the *WSJ* reported. Apple's suppliers are affected, as are companies that supply semiconductor chip packaging materials to auto chip manufacturers.

The energy supply woes combined with the Evergrande debacle have analysts slashing their estimates for Chinese economic growth for the remainder of this year.

(3) *Everyone wants LNG.* Demand for liquified natural gas (LNG) has surged from China, Europe, and Brazil, where a drought has reduced hydropower—on top of high preexisting demand from Japan. Natural gas in Asia and Europe trades at a sharp premium to the US commodity.

"With [natural] gas prices at record highs near $29 per mmBtu in Europe and Asia versus just around $6 in the United States, traders said buyers around the world would keep purchasing all the LNG the United States could produce. The United States exports about 10% of the gas it produces as LNG," a September 28 Reuters *article* explained.

US natural gas exports surged to a record high of 6.0 trillion cubic feet in March and held near that level in June, limited only by LNG facilities' capacity (*Fig. 6*). US stocks of crude oil and petroleum products are well below levels at this point of 2019 and 2020 (*Fig. 7*). US natural gas in storage is 6.9% below the five-year average at this time of year (*Fig. 8*).

Disruptive Technologies: Crypto Critics. Cryptocurrencies have had a tough few weeks. They've been denounced by none other than Securities & Exchange Commission (SEC) head Gary Gensler, JPMorgan CEO Jamie Dimon, and China. This helps to explain the 18.6% drop in the price of bitcoin since September 6, which is sharp but not enough to wipe out the currency's 44.2% ytd gain through Tuesday's close (*Fig. 9*). Let's take a look at what this trio of naysayers is saying:

(1) *China says "no go."* All cryptocurrency transactions and mining were banned by China last Friday. The country previously had raised concerns that crypto speculation could hurt the country's economy. Chinese officials also worried that crypto mining's high energy requirements would hurt progress toward the country's environmental goals. A September 24 Reuters *article* estimated that prior to the ban, virtual currency mining in China accounted for more than half of the world's crypto supply.

It’s also likely that Chinese officials didn’t like the lack of control they had over cryptocurrencies. They couldn’t prevent the flow of funds out of the country through cryptocurrencies. Instead, the country has introduced the digital yuan, which it created and will control entirely.

The world’s biggest crypto exchange, Binance, has been blocked from China since 2017. But other crypto exchanges have begun cutting relationships with Chinese customers since the announcement last week. Crypto exchange Huobi has stopped accepting new Chinese customers, and it will remove existing Chinese customers from its crypto exchanges by year-end, a September 27 *FT* *article* reported. Alibaba said it won’t allow merchants to sell crypto mining rigs. And FTX, Hong Kong’s biggest crypto exchange, has upped and moved its headquarters to the Bahamas.

(2) *JP Morgan’s Dimon doesn’t waver.* JP Morgan CEO Jamie Dimon has been a vocal critic of cryptos in the past. And he doubled down in a September 22 *interview* with *The Times of India* last week. “I am not a buyer of bitcoin. I think if you borrow money to buy bitcoin, you’re a fool.” He does, however, believe the government will step in and regulate cryptocurrencies.

(3) *Here comes Gary.* SEC Chairman Gary Gensler is calling cryptocurrencies a duck. If cryptos look like securities and act like securities, he’s saying, then they should be regulated like securities, something that seems far overdue.

Gensler wants crypto exchanges to register with the SEC, warning that if they fail to do so they’ll be hit with enforcement actions. He also has asked Congress to work with regulators to regulate stable coins. And he raised his concern about the public getting involved with “Wild West” crypto market. “I do really fear … there’s going to be a problem with lending platforms or trading platforms, and frankly when that happens a lot of people are going to get hurt,” he said according to a September 21 MarketWatch *article*.

Anyone who thinks Gensler is overstepping might consider reading this September 27 CNN *article* about a German hamster, Mr. Goxx. He runs on an “intention wheel” before picking a cryptocurrency and then runs through a buy or a sell tunnel to let its owner know how to trade the currency. These trading sessions are, of course, live-streamed on Twitch, and Mr. Goxx’s portfolio is up 16%.

Calendars

US: Thurs: GDP 6.6%, GDP Price Index 6.1%, Initial & Continuous Jobless Claims 335k/2.80m, Chicago PMI 65.0, Natural Gas Storage, Williams, Bostic. **Fri:** Personal Income & Consumption 0.3%/0.6%, Core PCED 0.2%m/m/3.6% y/y, Consumer Sentiment index 71.0, ISM M-PMI & Price Index 59.6/78.5, Baker-Hughes Rig Count. (Bloomberg estimates)

Global: Thurs: Eurozone Unemployment Rate 7.5%, Germany Unemployment Change & Unemployment Rate -33k/5.4%, Germany CPI 0.1%m/m/4.2%y/y, France CPI, France Consumer Spending 0.1%, Italy CPI -0.3%m/m/2.4%y/y, Italy Unemployment Rate 9.2%, UK GDP 4.8%q/q/22.2%y/y, UK Nationwide HPI 0.6%m/m/10.7%y/y, Japan Housing Starts 9.5%, Japan Unemployment Rate 2.9%, Japan Tankan Survey, Panetta, Mauderer, Kuroda. **Fri:** Eurozone CPI Flash Estimate 3.3% y/y, Eurozone, Germany, France, Italy, and Spain M-PMIs 58.7/58.5/55.2/59.4/58.2, Germany Retail Sales 1.5%m/m/1.9%y/y, UK M-PMI 56.3, Canada GDP -0.2% m/m, Schnabel. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) fell for the third week this week to 2.10—the lowest since May 2020; it was as high as 4.00 11 weeks ago—which was the highest since late January 2018. Bullish sentiment fell for the third week by 6.1ppts (to 46.5% from 52.6%), while the corrections account rose by 5.1ppts (31.4 from 26.3) over the same period. The former is down from its recent peak of 61.2% in mid-July, while the latter is up from its recent low of 23.5%. Bearish sentiment is little changed over the past three weeks at 22.1%, though is up 6.8ppts from its mid-July low of 15.3%. The AAII Ratio climbed to 43.3% last week after falling 58.8% to 36.4% the prior week, as bullish sentiment rose from 22.5% to 29.9% and bearish sentiment ticked down from 39.3% to 39.2%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady last week at a record high of 13.2%. Since the end of April, it has exceeded its prior record high of 12.4% in September 2018. It's now up 2.9ppts from 10.3% during April 2020, which was the lowest level since August 2013. Forward revenues and earnings per share both rose w/w. They've both been making new record highs since the beginning of March and for the first time since February 2020. Since the Q2-2020 earnings season came in way better than expected, analysts have been playing catch-up with their lowball estimates from the Covid-19 shutdown. Consensus S&P 500 forecasts had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues growth rose 0.1ppt w/w to 8.6%. That's down from a record high of 9.6% at the end of May and should continue to move lower due to base effects. Still, that's up from 0.2% during April 2020, which was the lowest reading since June 2009. Forward earnings growth of 15.1% was up 0.1ppt w/w, but should also continue to move lower due to base effects. That's down from its 23.9% reading at the end of April, which had been its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. On a positive note, analysts have been raising their forecasts this year for 2021 and 2022 revenues and earnings growth and the profit margin. They expect revenues to rise 15.0% in 2021 (up 0.1ppt w/w) and 6.8% (up 0.1 ppt w/w) in 2022 compared to the 2.1% decline reported in 2020. They expect earnings gains of 46.3% in 2021 (up 0.2ppt w/w) and 9.2% in 2022 (unchanged w/w) compared to a 13.4% decline in 2020. Analysts expect the profit margin to rise 2.8ppts y/y in 2021 to 12.9% (down 0.1ppt w/w) from 10.1% in 2020 and to improve 0.3ppt y/y to 13.2% in 2022 (unchanged w/w). The S&P 500's weekly reading of its forward P/E dropped 0.4pt w/w to an 11-month low of 20.7. That compares to 23.1 in early September 2020, which was the highest level since July 2000 and up from a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio dropped 0.06pt w/w to a four-month low of 2.72. That compares to a record high of 2.81 at the beginning of September and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Last week saw consensus forward revenues rise for five of 11 S&P 500 sectors and forward earnings rise for four. Seven sectors are at or near record highs in their forward revenues, earnings, and profit margin: Communication Services, Consumer Discretionary, Consumer Staples, Health Care, Industrials, Information Technology, and Materials. Energy still has all measures below record highs. Financials, Real Estate, and Utilities have forward earnings at or near record highs, but their forward revenues and margins are lagging. Only three sectors posted a higher profit margin y/y in 2020: Consumer Staples, Tech, and Utilities. For 2021, a y/y improvement is expected for all but Utilities. Four sectors are expected to see margins decline y/y in 2022: Financials, Health Care, Materials, and Real Estate. The forward profit margin was at record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Currently, seven sectors are at record highs. Here's how they rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (24.8%, down from its 24.9% record high a week earlier), Financials (19.1, down from its 19.8 record high in early August), Communication Services (16.7, record high), Real Estate (16.5, down from 17.0), Utilities (14.5, down from its 14.8 record high in early May), Materials (13.3, record high), S&P 500 (13.2, record high), Health Care (11.1, down from its record high of 11.2 in April 2018), Industrials (10.1, down from its record high of 10.5% in mid-December), Consumer Staples (7.6, 7.7), Consumer Discretionary (8.0, down from 8.3), and Energy (7.6, down from 8.0).

S&P 500 Sectors Forward Revenues and Earnings Recovery from Covid-19 Trough (*link*): The S&P 500's forward revenues and earnings as well as its implied forward profit margin bottomed at cyclical lows on May 28, 2020 after 14 weeks of Covid-19-related declines. Forward revenues and earnings have risen 18.7% and 52.3%, respectively, since then to new record highs. The forward profit margin has risen 3.1ppts to a record high of 13.2%, exceeding its prior record high of 12.4% in late 2018. During the latest week, seven of the 11 sectors posted gains or remained steady at new highs in either their forward revenues, earnings, or profit margin. Here's how the 11 sectors rank by their changes in forward revenues and forward earnings since May 28, 2020: Energy (forward revenues up 28.1%, forward earnings up 1,605.5%), Materials (28.1, 93.0), Information Technology (25.6, 43.2), Communication Services (24.4, 55.3), Industrials (23.0, 69.5), S&P 500 (18.7, 52.3), Financials (17.3, 66.0), Health Care (16.0, 28.1), Consumer Discretionary (13.7, 93.2), Consumer Staples (11.2, 18.5), Real Estate (9.4, 26.7), and Utilities (0.2, 4.8).

US Economic Indicators

Pending Home Sales (*link*): "Rising inventory and moderating price conditions are bringing buyers back to the market," said Lawrence Yun, NAR's chief economist. "Affordability, however, remains challenging as home price gains are roughly three times wage growth." The Pending Home Sales Index (which tracks sales when a contract is signed but the transaction has not yet closed) rose for the first time in three months, rebounding 8.1% in August to 119.5—8.3% below last August's level. Regionally, all four regions posted gains last month, though all four regions were below year-ago levels: Midwest (+10.4% m/m & -5.9 y/y), South (+8.6 & -6.3), West (+7.2 & -9.2), and Northeast (+4.6 & -15.8). Yun noted that it's not surprising that the more moderately priced regions of the South and Midwest are experiencing stronger sales, as more people have the flexibility to work from anywhere.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Index (ESI) for the EU was unchanged at 116.6 in September and broadly unchanged in the Eurozone (+0.2 points to 117.8), after falling in August from July's record highs of 118.0 and 119.0, respectively. They were 12.7 points and 13.8 points, respectively, above their pre-pandemic levels. The six largest EU economies were a mixed bag, with ESIs for Spain (+1.7 points to 109.4), Germany (+0.8 to 118.0) the Netherlands (+0.6 to 111.0), and Poland (+0.6 to 105.1) rising, while sentiment in France (-1.3 to 111.1) and Italy (-0.9 to 116.8) fell further. For the overall Eurozone, at the sector level, construction confidence advanced for the second month, by 3.5 points, to 7.5—the highest reading since mid-2019, while industry confidence climbed 0.3 points to 14.1, back near July's record high of 14.5. Consumer confidence continued to bounce around recent highs, climbing 1.3 points to -4.0 this month, back near June's -3.3—which was the best reading since January 2018; it was at -15.5 at the start of the year. Meanwhile, service confidence fell for the second month, by a total of 3.8 points to 15.1, after a six-month surge of 36.6 points to 18.9—which was its highest reading since August 2007. Retail trade confidence sank 3.3 points to 1.3 this month—which is considerably above this year's low of -19.1; it is 1.5 points above its pre-pandemic level.

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